

1918

# Foreign exchange

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To dismiss peremptorily, except for conduct most unseemly, a member of the staff who has been with us for several years would be a breach of ethics, to say nothing of being unjust.

The same thing might be said were a man who has become a part of our organization to resign without giving intimation of, or reason for, his act.

Delicate situations are bound to arise. They may seem impossible of solution which is at once ethical and satisfactory. One of the parties to a relation may find it not

entirely to his satisfaction or best advantage. It should not be taken for granted that the reproach of the other party will follow if a change is suggested. It should not be considered necessary to take him by surprise. The ethics in the case require that the matter shall be discussed with him fully and dispassionately. Out of the discussion may come a new or more satisfactory relation. If on the contrary a change seems desirable it may develop that the party may not only give his consent but add his God-speed.

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## Foreign Exchange

**B**ANKERS' long bills, bankers' short bills, cable transfers, commercial clean (long and short), commercial documentary (long and short), documents on acceptance and on payment, etc., are terms to terrify the uninitiated. Analyzed, they seem ridiculously simple.

Bills of exchange are issued either by banks or by merchants. Hence, the terms, bankers' bills and commercial bills. If they run over thirty days they are called long bills; thirty days or under, short bills. If they have no bills of lading attached, they are clean; with the bills of lading, documentary. In some cases the documents are surrendered upon acceptance of the draft; in others only upon payment. These variations in the form of exchange have little bearing on the accounting for foreign exchange.

The foreign exchange banker in New York who acts as the intermediary between the merchants of this and other countries, buys exchange and sells exchange. The exchange which he buys is that which consists of drafts drawn by merchants in this country against merchants in some foreign country. The price which he pays is determined by the economic law, namely, the demand for and supply of drafts on foreign countries. The exchange which he sells is

his draft against the credit established abroad by the drafts purchased or sometimes his credit with the foreign banks where he has connections.

When large quantities of American goods have been sold abroad the supply of exchange (drafts) on London, for example, increases. If there is more exchange offered than the banks and exchange brokers will take promptly the price sags. The more the offerings by exporters and the less the takings by the banks, the lower falls the price.

On the other hand, importers who have purchased goods abroad have need for drafts (on London, for example) with which to settle accounts. The relation of their demand to the supply of the banks fixes the price. As the demand gets out of proportion to the supply the price rises. It may, in consequence, go so high that it would be cheaper to obtain the gold, stand the expense of insuring and shipping it and take the loss caused by the wear and tear on the gold (abrasion). Any extensive shipping of gold will tend to decrease the demand for exchange so that the price of exchange will fall. The prices constituting the extremes of this range are known as the "gold points."

The books of the importer or the exporter

are little affected by the foreign exchange element. The importer receives his invoice, the draft, or the trade acceptance, as the case may be, in foreign currency, but he converts the amount into American currency before making the entry. Charging merchandise or some similar account he credits accounts payable, drafts payable, or acceptances payable. When the time comes to settle he ascertains from the bank how much it will cost him in American currency to purchase so many pounds, shillings and pence. If the amount, for which he sends his check to the bank and charges against the liability account, happens, on account of the fluctuation in exchange, to differ from the amount of the original credit, there will be a slight gain or loss in exchange. An entry is then made balancing the liability account and debiting or crediting profit and loss. The merchandise account is not disturbed.

The exporter has very little trouble in his bookkeeping on account of the foreign exchange feature. If he sells on open account there is no difference between an export and a domestic transaction. He charges accounts receivable when the goods are sold. He receives New York (dollar) exchange in settlement. If he sells by draft he charges drafts receivable and credits sales. If the draft is sold to a bank the proceeds which he receives are charged to cash and credited to drafts receivable. Any difference between this and the original amount charged to drafts receivable is a loss or gain on exchange. The draft account and the profit and loss account are adjusted accordingly.

Where there are frequent transactions between concerns in two countries, such as an American house with a French branch, or a New York concern acting as representative of a London business, it is customary to have a standard rate of exchange on which basis all transactions during the accounting period are computed. The balance at the end of the period is then priced at the market rate on such day, the difference

being taken up as the gain or loss on exchange.

(To be continued)

### Solution to Cost Problem

THERE appeared in the June number of the BULLETIN the following problem:

"For cost purposes, how should graded leaf in the cigar industry be priced? Should grade No. 4 be treated as of the same price as grade No. 1, provided it came from the same hogshhead? If this is done it will happen that a month when the factory works chiefly on low-grade tobacco may show a loss, while a month when it works chiefly on high-grade goods will show an abnormal profit. If the grades out of the same hogshhead are treated as of different prices, how should those prices be determined?"

A solution to the problem submitted by Mr. R. M. Wilbur, of the New York staff, follows:

"Different grades of leaf tobacco from the same hogshhead should be priced for cost purposes on a differential basis.

For example: Assume that the Banks Company purchase 1 hogshhead of leaf tobacco weighing—

400 lbs. @ \$2.50 per lb., cost \$1,000.00

Assume further that upon receipt at their factory this tobacco is graded as—

No. 1 tobacco 200 lbs.

" 4 " 200 "

and that the value of one pound of No. 1 tobacco is four times that of one pound of No. 4.

No. 1 — 200 lbs.  $\times 4 = 800$

" 4 — 200 " = 200

1000

80% of \$1000.00 = \$800.00

20% " 1000.00 = 200.00

100

\$1000.00

service. I believe that the imprint you leave will be one that reflects credit to those who have spent careful efforts in your preparation for the work to be assigned you."

*The Louisville Courier-Journal* of August 20, 1918, in commenting editorially on the occasion compliments Colonel Carter as follows:

"In making the Artillery School at Camp Zachary Taylor the only one in the United States and in arranging to graduate a class of officers every week for the duration of the war, the War Department paid Louisville and the camp a great compliment and reposed in them a very sacred trust. But in naming Lieut. Col. Carter as commandant of the school, the War Department puts its mark on him as the best artillery instructor in the United States, and that involves more than a sacred trust—it involves a responsibility great enough to make weak men recoil. Col. Carter has accepted the responsibility, and his first class is eager to prove that the War Department made no mistake in their 'prexy's' selection."

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### Boston Office

The firm announces the opening, under date of August 15, 1918, of an office at 84 State Street (India Building), Boston, Massachusetts. Mr. R. K. Hyde has been appointed manager.

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### Foreign Exchange (Continued)

#### DOLLAR LETTERS OF CREDIT

**B**RIEFLY, a Letter of Credit is written authority given to one party, usually a vendor, to draw drafts on a bank or banker for account of a third party. There are several classes and kinds of Letters of Credit, but where the drafts are to be drawn in dollars on an American bank, we have the Dollar Letter of Credit, which has become an instrument of importance in international trade almost overnight.

For example, take raw silk purchased in Japan for shipment to New York for the purpose of being manufactured in the mill

towns of New Jersey. The distance between New York and Japan is so far that it is difficult for the vendor to inform himself as to the credit standing of the importer or knowing once to keep his information up to date. There are many cases, of course, where the shipper abroad has absolute confidence in the importer and gladly sells on open account. Far oftener the importer is known abroad only in a general way, and according to custom, provides the seller with the guarantee of a bank in the form of a Letter of Credit.

The next question is as to the kind of a letter of credit which will be satisfactory. Must it be opened through a Japanese bank in yen or a London bank in sterling, or will one opened through a prominent New York bank in dollars be acceptable to the merchant in Japan? All this merchant really cares about is the price for which he will be able to sell his draft covering the value of the silk.

This brings up for consideration the discount market in the city on which the Letter of Credit is to be opened, because, after the draft has been accepted, it will probably be sold there as a bank acceptance. The amount which the local banker will pay our vendor in Japan will depend on the price for which he will be able to discount the draft in the city on which it is drawn.

London, for hundreds of years, has been the great commodity market of the world. There one will find a most complete equipment of docks, warehouses, auction rooms, and other conveniences for handling international commerce. Buyers have been compelled to go there and buy raw material from all over the world at retail, so to speak. London banks have prestige and the experience in buying and selling commercial bills which results from handling all this business successfully for a long period of time. London banks are in possession of a huge fund of capital from the accumulated profits of years of success and from the balances of banks and merchants all over the earth who have found it advan-

tageous to carry balances at this great market centre. This capital is always seeking profitable investment and has enabled London to build up and maintain the most important of all discount markets.

Prior to 1913, although our imports and exports were large in volume, the banking laws of this country would not permit national banks to accept time drafts. The Federal Reserve Law, however, provided, in substance, that member banks might "accept drafts not having more than six months' sight to run and growing out of the importation or exportation of goods up to the amount of one-half their capital and surplus." The bill also provided for the purchase by the Federal Reserve Banks of such drafts after acceptance. For the first time in history this country found itself in possession of the machinery to compete with other nations for our just share of international trade.

Why should we be compelled to buy at retail in London or, in buying direct, be compelled to allow a London bank to come into the transaction and collect a commission? Formerly, it was because drafts drawn on New York in dollars would have to be held until maturity as an investment or sold at a cheap price in a foreign discount market. The vendors abroad were surely justified in asking for sterling credits.

The war has changed the situation for the time being. The fund at London is partly depleted and the balance is being used to finance the war. This has abated the keen competition. There is the further important reason of loss or delay of documents passing in and out through the war zone, and, of course, raw materials cannot be handled for re-export through the London market.

Without effort on our part we have been placed in a position where dollar credits are the only ones acceptable to the exporters abroad. We find ourselves issuing an amount greater than we could have hoped for after years of competition in times of peace. The dollar and the names of our banks

are finding their way to the remotest corners of the earth where formerly only the pound sterling and the local currency were known.

We must remember that this new business has come so easily because our competitors are busy with other things. London still holds the balance of banking power and the apparatus for handling international commerce. Her merchant fleet, we know, will be partly saved and all rebuilt. Later, we shall have to retain the old and obtain the new business in competition with her. American enterprise will be glad of the opportunity to meet the other nations on equal terms and to succeed solely on the basis of merit.

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### Efficiency in Reality

**I**T was a saying of Napoleon that every soldier carried in his knapsack the baton of a marshal. So true is this that all who set foot on the path of business advancement feel the desire for a larger opportunity and the possibility of an increased efficiency.

This word "efficiency" suffers from many disagreeable connotations which have grown up around it. The conception of a machine-like uniformity—the precision of an automaton—applied to human effort has at times overshadowed the real and indispensable good in an intelligent efficiency. For intelligent it must be first of all; without a mind in control the labor of a man's hand is so much lost motion.

For our purpose, efficiency may be roughly defined as the power to do the work before us in the best possible way, in the least possible time, and with the least possible effort. In short, it is the ability to find the best way of arriving at the best results. A good piece of work is an achievement in itself; when it has been accomplished with the least possible expenditure of time and effort it is a product as nearly perfect as human skill can make it, and the man whose work it is has felt a joy in the doing that is denied to a fumbling or less finished craftsman.

## Foreign Exchange (Continued)

### DOLLAR LETTERS OF CREDIT

**C**ONTINUING the discussion of the dollar letter of credit described in the preceding article: When the importer in New York has arranged to settle for purchases of silk in Japan by this means, he will go to his local bank and make out the formal application for the credit. This will cover the total amount of drafts to be drawn, the time within which they are to be drawn, the tenor of the drafts, a brief description of the merchandise to be shipped, and the documents required.

The opening of the letter of credit is, of course, granting accommodation to the importer and authority must be obtained from the department which checks credits.

The clerk in the Foreign Department is now ready to have the formal letter of credit drawn up. The wording is quite lengthy, but in substance the New York bank addressing the vendor in Japan provides that if the vendor ships certain goods, which are described, within a certain time, and attaches the shipping documents which are named, usually bills of lading, insurance certificates covering marine and war risks, a consular invoice and a commercial invoice, to the draft for the selling price of the goods, they (the New York Bank) will accept the draft in accordance with the terms of the letter of credit. At the same time the bank has a contract drawn up in duplicate, which is signed by the bank and the importer, covering the letter of credit. The importer promises to reimburse the bank one day before maturity for all drafts accepted by the bank under the letter of credit. The issuing of the letter of credit and the executing of the contract cause a double contingent liability to spring up. First, there is the promise of the New York bank to the vendor in Japan to accept drafts drawn in conformity with the terms of the letter of credit, and there is the offsetting promise of the importer in New York to reimburse the bank for drafts accepted under the letter of credit.

This double contingent liability should always be reflected through the accounts of the bank. Sometimes only a memorandum account is kept, which is satisfactory provided the correctness is verified at regular intervals. National banks are required by the Comptroller of the Currency to use offsetting accounts in their statements. The promise of the importer to the bank is shown by a charge to an account called "Customers' Liability under Letters of Credit and Acceptances," which from the point of view of the bank represents a contingent asset. The promise of the bank to the vendor is reflected in an account entitled "Unused Letters of Credit," a contingent liability. These two accounts are carried in the general ledger of the Foreign Department. The Unused Letter of Credit account is a controlling account.

The subsidiary record will take the form of a loose-leaf book with one page for each letter of credit opened. The pages will be arranged in alphabetical order according to the names of the customers for whose account the letters of credit are opened. On the loose-leaf sheets there will be given the details of the letter of credit and a description of the merchandise to be shipped, and ample space will be provided for a record of drafts accepted and documents received, and a description of the merchandise the documents represent. The importer mails the formal letter of credit to the vendor in Japan, who places his merchandise on board the vessel, receives his bills of lading, takes out the necessary insurance and receives certificates therefor, and makes up the consular invoice and has it attested. Now the vendor mails one copy of the bill of lading to the bank in New York with a letter describing briefly the merchandise shipped and the draft drawn. Two copies of the bills of lading, one copy of each insurance certificate, the consular invoice and the commercial invoices are attached to the original draft which he has drawn. Other copies of the

bills of lading and any other documents are attached to the duplicate draft. The vendor takes both original and duplicate copies of the draft to his banker in Kobe or Yokohama and sells them for a price in yen. He is able to do this because he exhibits a letter of credit of a New York bank. If he prefers, which is seldom, he may deposit the draft for collection. The Kobe bank sends the draft to London or New York for negotiation or collection, and finally, after passing through the hands of several banks and bankers, the draft is presented at the window of the New York bank for acceptance. The letter advising the drawing of the draft has probably been received previously and held by the New York bank awaiting presentation of the draft.

Acceptance of the draft and the examination and disposition of the documents will be covered in the next article.

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We take great pleasure in announcing that Mr. Ludlam has been requested to go to France to take charge of the accounting between the United States and the Allied Governments.

The undertaking, we understand, will include not only the transactions among nations and individuals incident to the military operations, but as well the final settlements at the peace table. It is probably the largest and most important accounting task the world has ever known.

Mr. Ludlam's rank has not yet been fixed, but it is probable that he will receive a military commission in keeping with the dignity and authority which the work will require. The staff which will accompany Mr. Ludlam will consist of three majors, six captains, sixteen lieutenants, thirty privates, and the necessary force of secretaries, stenographers, and clerks.

It has been decided not to draw on our organization for the purpose of making up this force. The firm feels that the need for accountants in our own country is now acute.

Moreover, as the Government has already claimed the services of Mr. Dunn, the additional sacrifice in giving up Mr. Ludlam is so great that further withdrawals from the organization would not be desirable.

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As a result of the recent meeting of the members of the firm and managers, Mr. H. S. DeVault was appointed associate manager of our Atlanta office, and Mr. H. F. Farrington associate manager of our Watertown office.

Because of the long continued illness of Mr. C. H. Banks, and our desire to relieve him of the routine work of the Denver office and the pressure attendant on the busy season of the year, Mr. J. F. Pflug, of the Chicago office, has been appointed manager. Mr. Banks will continue his connection with us as associate manager.

The demands of our Report Department have made it necessary to associate someone with Mr. Vaughan. Mr. W. H. Bell, of the St. Louis office, who has had considerable experience in that class of work, has been called to New York for that purpose, and Mr. J. H. O'Connell, the ranking member of the St. Louis staff, has been appointed to succeed him as manager. This change becomes effective November first.

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We feel a glow of pride in the spirit and achievement of "our boys" in the service, many of whom remember us in the midst of most arduous work. A letter to Mr. Sells from Mr. T. E. Henriques, formerly of the New York staff, gives an enthusiastic picture of his life at Fort Hancock, Georgia:

"Camp Hancock, Georgia.

"September 18, 1918.

"Dear Mr. Sells:

"Am enclosing a picture to let you see what two months' training will do for a young man in the service. If parents knew